



Republic of Indonesia

**Indonesia Road Map and Policy,
Review and Progress**

Speech By

Dr. Boediono

Coordinating Minister For Economic Affairs

*Aligning Macro Policy to Accelerate the Provision of
Infrastructure in Indonesia*

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Distinguished Guests, Ladies and Gentlemen,

The theme of my address is about the balancing of infrastructure provision and sound macro-economic management. As the Coordinating Minister for Economic Affairs **and** Chairman of KKPPI the Infrastructure Development Committee, this is one of my responsibilities.

Infrastructure, as we all know, is an important driver of economic growth, and poor infrastructure constrains growth by deterring foreign and domestic investment. We recognize the importance of infrastructure, and we want its development to be rapidly accelerated. However, since the crisis Government's ability to make this happen has been limited by budgetary constraints. It is impossible for the state budget to fund all the infrastructure that the country needs, without adversely and severely increasing our budget deficit and public sector borrowing. Thus, current economic circumstances dictate the need to resort to private sector participation, targeted mainly at injecting private finance into the infrastructure sector. Simply put, private sector participation (PSP) in infrastructure is accordingly an imperative rather than an option.

Distinguished Guests, Ladies and Gentlemen,

Let me begin my remark by highlighting current macroeconomic developments and their likely path over the medium term. I will emphasize a few macroeconomic indicators which may affect investment decision in infrastructure in this country.

First, the economy is on a gradual but steady upward trend. After being hit hard by the crisis in 1998, our economy showed its resilient by growing steadily from 3-4 % p.a in 2000-2003 to 4-5% p.a in 2004-2005. It is currently on a growth trajectory of 6% p.a. and over the next 3 years, we expect our economy to grow by 6-7 % p.a. In 2010 and beyond, we hope to grow by 7+% p.a., our growth trajectory for 30 years before the crisis.

Acceleration of our economic growth has two implications. From a supply perspective, we need higher investment in infrastructure to support enlargement of the economy. Similarly, on the demand side, expansion of the economy will raise the commercial viability of infrastructure investment.

Second, investment in infrastructure is long term, requiring macroeconomic stability. Currently we witness a firm reestablishment of economic stability. Inflation has been successfully brought down to about 7% in this year from about 17% in 2005. In the medium term, with continued prudent monetary and fiscal policies, we expect that our inflation rate will come down to 3-4 % p.a, a level closer to the regional norm. With a positive outlook on macro stability, the cost of finance will correspondingly decline and lengthen— the tenor or maturity of loan lengthens. The availability of domestic financing is essential for the investors in infrastructure sector to mitigate foreign exchange risk and to facilitate Rupiah financing instruments.

We also understand that Indonesia's risk is still higher than some other countries in this region. But as we witness our budget deficit has come down considerably since the crisis period and has recently been contained at around 1 % of GDP. Correspondingly, our public debt to GDP ratio has been falling fast from about 100% GDP in 1999 to below 40% of GDP by the end of 2006 and is likely to continue falling thereafter. This improvement has been recognized by all rating agencies by steadily upgrading Indonesia's rating.

Let me elaborate another aspect of our fiscal commitment that is our aim to create fiscal space for supporting the expansion of infrastructure including for PPP development.

First, as we promised in the Infrastructure Summit last year, the allocation for development spending as a rough proxy public investment has since risen noticeably. Total public investment in 2006 is expected to exceed 7% of GDP and about the same in 2007. Half of the investments are carried out through regional budgets. This level is quite comparable to the pre crisis public investment level.

Second, we have gradually raised our expenditures on infrastructure. Total amount of such spending for all levels of government has increased from Rp. 35 trillion in 2005 to Rp 44 trillion in 2006, both measured at 2006 constant prices. This translates to about 26% real increase. We have agreed with the Parliament to increase this allocation in the 2007 budget. The exact number will be determined soon, but it will not be below the 2006 amount.

Third, in addition to regular infrastructure expenditure. We intend to set aside a budget to support risk sharing, and land acquisition schemes and to provide seed capital for PPP development. For such purposes this year we have allocated Rp 2.7 trillion and next year, the Parliament has approved an additional Rp 2 trillion. The Minister of Finance will elaborate further on this issue in the next speech.

Distinguished Guests, Ladies and Gentlemen,

Our commitment to support PPP will broadly depend on our progress on policy reform. This year we have issued three policy packages. The first package deals with an effort to accelerate infrastructure development, while the second package addresses the ways to improve the investment climate in general. The third package, issued last June, deals with reforms in the financial markets including SOE reform.

All the three packages will have direct and indirect impacts on the PPP development. Details on each three packages regarding policy reforms and its progress on implementation are available in our website – www.ekon.go.id or come visit our booth in the exhibition center.

Distinguished Guests, Ladies and Gentlemen,

Let me now report you what we have done to improve regulatory environment for PPP.

On the institutional front, in February 2005 the Government has strengthened KKPPI—the inter-Ministerial-Committee for Infrastructure Development. Through KKPPI, the Government is attempting to coordinate the PPP investment opportunities in government agencies as well as in State enterprises tasked with project preparation, tendering, negotiation and implementation oversight. KKPPI will play its role in coordinating PPP investment, in prioritizing investment opportunities, in promoting competition and transparent transaction, and in accelerating and in facilitating decision-making.

Other substantive gains have been made in the cross-sector area. Presidential Regulation No. 67/2005 or Perpres 67, issued on 9 November, 2005, defines the cross-sector regulatory framework for the private provision of infrastructure.

Perpres 67 is a landmark. Firstly, it provides a clearer, more transparent and accountable basis for infrastructure investment by the private sector. As President SBY has noted, Perpres 67 will ensure that procurement of PPP concessions are done on a competitive and transparent basis. Although it allows for the unsolicited approach, this is discouraged as a rule.

Secondly, there is the emphasis on partnership, of mutual benefit and gain that can be expected from a PPP project in Indonesia. Without this principle, it would be difficult to sustain the government's PPP program.

Thirdly, government agencies must prepare a PPP project well, with detailed feasibility studies and internationally recognized bidding documents -- before it is offered to the market. This would help reduce the cost of doing business in Indonesia, especially when the development costs of a PPP project are high. If the government agencies fail to do this, delays and extra costs in transacting a PPP will be incurred by both the government and the private investors. In this regard, a project development facility (PDF) will be established to fund project preparation. The money from the PDF fund will be allocated on a competitive basis and fund projects with a higher priority first.

Lastly, Perpres 67/2005 stipulates that government financial support can and will be provided for projects that meet specific criteria. Indonesia will abandon its approach of providing blanket guarantees as we have in the past and instead provide explicit guarantees for specific private infrastructure investments within the government's PPP framework. The PPP framework is supplemented by the Minister of Finance Regulation 38/2005 on Implementing Control and Management of Infrastructure Provision Risks. This regulation highlights the need for the risk management process to support the provision of infrastructure so as to enable more rapid economic growth while ensuring fiscal sustainability. Among others, it defines:

- the types of risk that Government is willing to bear or share, namely certain types of political, project performance, and demand risks;
- the types of Government contingent support that can be considered, and the criteria to be used in deciding the form and amount of Government support;

- the procedures to be followed in evaluating and responding to requests for Government support, including making the needed budgetary provision;
- The requirements for monitoring and reporting on the evolution of project risks.

Both the PPP framework and risk sharing regulation are now being 'tested' as sector ministers propose projects for Government risk-sharing, and we anticipate that both may be further refined at some stage based on the valuable lessons of experience. My colleague, the Minister of Finance, will provide more detail on this policy framework in her speech to follow.

Distinguished Guests, Ladies and Gentlemen,

At the sectoral level, the regulatory reforms have also progressed well. For some sectors, such as toll road and water supply and sanitation, new laws have been introduced to replace the old ones; while for other sectors, the revision is still in progress. Draft laws for the ports, airports and railways have been submitted to Parliament for deliberation and expect them to be past in early 2007. One important theme in these laws is the phasing out of the monopoly power of the SOEs in infrastructure services which we think has so far hindered efficiency and stifled investment in this sector. If the laws are passed, wider opportunities will be open up for private investments in railways, harbors and airports and other sectors.

My sector colleagues will provide more information on specific reforms in their respective sectors in the break-out session later this afternoon and tomorrow. They will also provide information on specific model transactions that we would like to present to the investment community as a whole. But there is one principle that our government will adhere to throughout this process – that is, we will support a transparent and competitive PPP framework, free of potential conflicts

of interest, and to the best of our abilities ensure a level playing field for all prospective investors.

Distinguished Guests, Ladies and Gentlemen

I now move on to the topic of land and its acquisition for PPP projects. Unlike in many other countries, in Indonesia PPP projects have been tendered when the land required for project completion has not yet been acquired. To be competitive and in line with other countries, we would like to gradually phase out this practice, as we all know too well that private investors are reluctant to enter into a concession agreement when significant uncertainty on land acquisition remains. Perpres 36/2005 and Perpres 65/2006 are designed to shorten the land acquisition process and to cap land cost.

In addition, the government is committed to setting up a land revolving fund. As of today, the government has already allocated Rp 600 billion in 2006 for land acquisition. An entity has been established in the Ministry of Public Works as the agency to implement land acquisition. In addition, new implementing guidelines have been drafted by the National Land Agency, BPN, to ensure that all land acquisition be done in an investor-friendly manner, but not at the expense of the displaced and vulnerable groups of society living on the land.

These policies will, to a great extent, help ensure land is acquired for the project before it is tendered out. The question of prioritizing the use of the money in the fund is something that KKPPI will be mandated to address. The topic of land acquisition will be addressed in greater detail by the Minister of Public Works in the break out session later this afternoon.

Distinguished Guests, Ladies and Gentlemen,

Under the First Infrastructure Summit in 2005, the government announced 91 projects. And while some of these projects were subsequently tendered to the market, the overall market response on these set of projects have been relatively poor. There are a number of factors that have been the cause of the poor response. One of the main reasons, I believe, is that the projects were not properly and adequately prepared. We have learnt from this experience, and as a result, in this 2006 IICE , we have identified just 10 projects that will be implemented in a model way to comply with existing regulations and are being prepared more carefully before being put out for tender.

We have learnt that we must balance ambition with credibility. We don't want to repeat past mistakes. But our present dilemma is this: We intend to adopt best practices for the PPP; and we recognize that many projects offered to the private sector, for various reasons, have not been prepared to sufficiently high standards. Unfortunately, time is not on our side, and we simply cannot afford to restart the preparation process for all projects in our current pipeline. Rather, we are now following a two-fold strategy under which we are:

- striving to improve the documentation of projects that are already far advanced in preparation; and, in parallel,
- initiating preparation of carefully selected set of 'best practice' demonstration projects to serve as models for the future.

Many of the 91 projects that we displayed in last years' Infra Summit were projects tendered prior to Perpres 67 – some with concessionaires already in place, some with pre-qualified bidders already selected, some tendered without any mention of public support, but all having not reached financial closure. We try to solve those problems on sectoral basis. My colleague, technical ministers

will elaborate the solution in detail when they present sectoral presentation in the break-out session tomorrow.

In closing, let me reiterate the three declarations that the Government put before you during the last Infrastructure Summit.

1. The Government will focus its own resources increasingly on sectors which are not commercially viable or will not attract private investment.
2. The Government will focus on sectoral reforms that will ensure a continually larger portion of infrastructure services are commercially viable and allow sustainable private sector participation in infrastructure investment and provision.
3. More immediately, the Government will enact programs to support greater private sector involvement in infrastructure investment and provision through creating and maintaining public-private partnerships in infrastructure services and by removing bureaucratic bottlenecks which currently inhibit private sector involvement.

We remain committed to these three principles, and we want to attract mutually beneficial private participation in sound infrastructure investments that will fuel and support our economic growth.

I want to take this opportunity to thank you all for attending the 2006 IICE. Please help us help you make your investments in Indonesia truly successful.

Terima Kasih.